

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: Banking and Insurance Committee

BILL: CS/SB 660

SPONSOR: Banking and Insurance Committee and Senator Carlton

SUBJECT: Assets Held in Benefit Plans

DATE: March 22, 2005

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Cibula</u>	<u>Maclure</u>	<u>JU</u>	<u>Fav/2 amendments</u>
2.	<u>Knudson</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Fav/CS</u>
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

This committee substitute revises several provisions of law related to estate and tax planning. The committee substitute also creates hurricane savings trust accounts for the purpose of paying the windstorm deductible on a homeowner's property.

Assets Exempt from Creditor Claims

Funds held in the Florida Prepaid College Program and the Florida College Savings Program are exempt from creditor claims under existing Florida law. The committee substitute provides that Coverdell Education Savings Accounts, which are tax-advantaged accounts used to save for education expenses, are accorded the same treatment.

The committee substitute increases the creditor protection afforded individual retirement accounts and tax-qualified employee benefit plans. The committee substitute also includes governmental and church plans that are tax-exempt to the exemption from creditor claims.

Benefit Plans

The committee substitute broadens the definition of the term "benefit plan" to mean a retirement plan that may include, but is not limited to, any pension, profit-sharing, stock bonus, or stock-ownership plan or individual retirement account. The committee substitute then provides that these benefit plans may be delivered to a custodian for the benefit of a minor, to a child's parents as natural guardians, or to a trustee designated by the owner of the benefit plan upon the death of the owner. The committee substitute also raises from \$10,000 to \$15,000 the amount that may be given to a custodian by certain persons without court involvement.

Additionally, the committee substitute defines the term “qualified minor’s trust” as a trust that complies with s. 2503(c) of the Internal Revenue Code. That code provision requires that trusts for the benefit of persons under the age of 21 distribute their assets to the beneficiary when the beneficiary reaches the age of 21. The committee substitute further provides that an adult custodian of property for a minor may transfer the custodial property into a qualified minor’s trust.

Hurricane Savings Trust Accounts

Adds hurricane savings trust accounts to the types of assets protected from creditors. The amount that may be protected from creditors is limited to twice the deductible of a person’s homeowners’ insurance.

This committee substitute substantially amends the following sections of the Florida Statutes: 222.21, 222.22, 710.102, 710.104, 710.108, 710.116, 733.808, and 744.301.

II. Present Situation:

Assets Exempted from Legal Process

Under the Federal Bankruptcy Code, a state may specify assets of a debtor in a bankruptcy proceeding which are exempt from creditor claims.¹ Under ch. 222, F.S., Florida has protected the following items from creditor claims:

- Homestead property (s. 222.01-222.05, F.S.).
- Certain items of personal property (s. 222.061, F.S.).
- Certain disposable earnings of head of family (s. 222.11, F.S.).
- The proceeds of a life insurance policy (s. 222.13, F.S.).
- The cash surrender value of a life insurance policy and the proceeds of an annuity contract (s. 222.14, F.S.).
- Disability benefits payable from any insurance (s. 222.18, F.S.).
- Certain pension, retirement, or profit sharing benefits (s. 222.21, F.S.).
- Prepaid College Trust Fund moneys and Medical Savings Account funds (s. 222.22, F.S.).
- A debtor’s interest in a motor vehicle, up to \$1,000 in value (s. 222.25, F.S.).
- The debtor’s interest in any professionally prescribed health aids (s. 222.25, F.S.).
- Social security benefits, unemployment compensation, or public assistance benefits; veterans’ benefits; disability, illness, or unemployment benefits; alimony, support, or separate maintenance; and stock or pension plans under specified circumstances (s. 222.201, F.S., recognizing a subclass of property for federal exemptions under 11 U.S.C. s. 522(d)(10)).

Fraudulent transfers, conveyances, or other fraudulent asset conversions are not exempt from legal process under s. 222.29 and s. 222.30, F.S.

¹ See 11 U.S.C. s. 522(b) and s. 222.20, F.S.

Assets In Qualified Tuition Programs and Education Savings Accounts

The Legislature established the Florida Prepaid College Program (prepaid program) and the Florida College Savings Program (savings program) as qualified tuition programs under 26 U.S.C. s. 529. Under the prepaid program, an individual can lock in the cost of attending a Florida college or university today.² Under the savings program, an individual may make investments in a small range of investment options to fund the costs of attending undergraduate and graduate schools across the nation.³ Distributions from either program are generally tax free.

The Legislature specifically exempted the prepaid program and the savings program from legal process under s. 222.22, F.S., and from claims of probate creditors under s. 732.402(2)(c), F.S. Since the creation of the programs, Congress has expanded the tax benefits under the Internal Revenue Code to allow for the creation of other education savings accounts such as the Coverdell Education Savings Account (Coverdell ESA)⁴ and qualified prepaid education programs.⁵ Distributions from Coverdell ESAs are generally tax free. Up to \$2,000 per year may be contributed to a person's Coverdell ESA(s).⁶ Coverdell ESAs may be invested in a broader range of investments than those authorized under the savings program described above.

Assets in Health Savings Accounts and Medical Savings Accounts

Health Savings Accounts (HSAs) and Archer Medical Savings Accounts (MSAs) provide tax benefits to account owners with high deductible health plans. Moneys in the accounts must be used for medical expenses not covered by the health plans. Contributions to HSAs and MSAs are generally tax-deductible. Additionally, the interest and earnings on the account are generally tax-free. The accounts differ in the size of the deductibles required and the amount that may be contributed to the accounts annually. Further, MSAs are limited to the self-employed and small employers. Moneys paid into a Medical Savings Account are exempt from legal process.⁷

Assets Derived from Death Benefit Proceeds

Under s. 733.808, F.S., death benefits from certain insurance contracts or certain employee benefit plans may be payable to a trustee of a trust created by the decedent. If the trustee does not claim the death benefits within six months after the decedent's death, then the insurance company or obligor must pay the benefits to the personal representative of the estate unless otherwise provided by agreement with the insurer. Such death benefits are not a part of the probate estate. Thus, they are not subject to taxes, debts, or other creditor claims, nor are they used to compute the commission to a personal representative or the fees owed to the personal representative's attorney. Death benefits are also exempt from liability for the payment of

² FLORIDA PREPAID COLLEGE BOARD, THE EARLIER, THE BETTER: FLORIDA PREPAID COLLEGE PLAN, *at* <http://www.florida529plans.com/prepaid/index.html>.

³ FLORIDA PREPAID COLLEGE BOARD, A NEW WAY TO SAVE: FLORIDA COLLEGE INVESTMENT PLAN, *at* <http://www.florida529plans.com/savings/index.html>.

⁴ *See* 26 U.S.C. s. 530

⁵ *See* 26 U.S.C. s. 529

⁶ *See* INTERNAL REVENUE SERVICE, PUBLICATION 970, TAX BENEFITS FOR EDUCATION, at 1 (2004).

⁷ Section 222.2(2), F.S.

expenses of administration, obligations of the estate, or contributions required under s. 733.607(2), F.S.

Assets Derived from Settlement of Claims or Causes of Action on Behalf of a Minor

Under s. 744.301, F.S., parents as natural guardians are authorized to settle claims on behalf of their children and manage the proceed of those claims and property distributed from an estate, trust, or life insurance policy for amounts that do not exceed \$15,000. Courts may appoint a guardian *ad litem* or legal guardian to represent the interests of a minor for legal claims exceeding \$15,000.

Assets Transferred to a Minor

Under the Florida Uniform Transfers to Minor Act under ch. 710, F.S., a person may transfer property to an adult as custodian for a minor. Court authorization or a guardianship may be required for certain transfers of property valued in excess of \$10,000. A custodian is authorized to use the custodial property for the benefit of the minor without a court order as required in guardianships. Additionally, complex governing documents as needed in trusts are unnecessary. Funds, however, may be subject to estate taxes if the donor of the funds is the custodian of the account.⁸

Assets in Qualified Minor's Trusts

A transfer of assets to a trust for the benefit of a person younger than 21 years old is exempt from gift taxes if the trust may be expended by or for the benefit of the beneficiary and passes to the beneficiary upon reaching the age of 21.⁹ According to the Real Property, Probate, and Trust Law Section of The Florida Bar, these trusts provide for the continued management of the funds with the consent of the beneficiary when the beneficiary turns 21.

Assets in Retirement or Profit Sharing Plans

Under s. 222.21(2)(a), F.S., any money, assets or interest that are payable or belong to a participant or beneficiary of a retirement or profit-sharing plan that qualifies for tax exempt status under the Internal Revenue Code¹⁰ is exempt from the claims of creditors. However, the determination of whether retirement assets are excludable from a bankruptcy estate is governed not only by the Florida Statutes, but also the U.S. Bankruptcy Code, the Employee Retirement Income Security Act (ERISA), and Florida case law.

Section 541(c)(2) of the Bankruptcy Code excludes from a bankruptcy estate any beneficial interest of a debtor in a trust that is subject to a restriction or transfer enforceable under applicable non-bankruptcy law. The Florida Bankruptcy Code in s. 522(b) permits a debtor to elect to apply the exemptions found in s. 222.21(2)(a), F.S., and exempt the assets in the

⁸ Jani Maurer, *Uniform Transfers to Minors Act Accounts--Progress, Potential, and Pitfalls*, 28 Nova L. Rev. 745, 761 (2004).

⁹ See 26 U.S.C. s. 2503(c).

¹⁰ The provisions of the Internal Revenue Code of 1986, as amended, that qualify a plan for tax exempt status are s. 401(a), s. 403(a), s. 408, s. 408A, or s. 409.

retirement or profit-sharing plan from a bankruptcy estate. In *Patterson v. Shumate*,¹¹ the U.S. Supreme Court determined that it is an “ERISA Qualified” plan that is excluded from the debtor’s estate under s. 541(c)(2) of the Bankruptcy Code. The Florida Courts have determined that in order for a retirement plan to be “ERISA” qualified, it must be subject to Part 2 of Title 1 of ERISA,¹² contain an antialienation clause,¹³ and be tax qualified under s. 401(a) of the Internal Revenue Code.¹⁴

In Florida, a good deal of litigation has surrounded the question of whether a pension or retirement plan or profit sharing agreement qualified as being exempt from creditors. The key issue has often been whether the plan qualified for a tax exemption because s. 222.21, F.S., requires that such a plan be tax exempt in order to be exempt from creditor’s claims. The Florida courts have allowed creditors to question the tax-qualified status of plans that have not been disqualified by the IRS. Another issue that has arisen is that certain retirement or pension plans and profit sharing agreements are not protected from creditors because they are not covered by Part 2 of Title 1 of ERISA. An example of this is a plan that covers the owners of a partnership or corporation.

Hurricane Deductibles

In 2004, many Florida citizens with hurricane damaged homes experienced financial losses due to the application of hurricane deductibles on their residential policies. The Legislature first authorized the use of separate, percentage hurricane deductibles for residential policies in 1993 after Hurricane Andrew. Currently, s. 627.701, F.S., establishes the maximum and minimum hurricane deductibles that are allowable and mandates that insurers offer hurricane deductibles of specified amounts. The Legislature’s purpose in allowing for percentage deductibles, as expressed in statute, is to limit premium increases and to increase the availability of hurricane property insurance in Florida. Approximately 76 percent of Florida homes have a hurricane deductible equal to 2 percent of the insured value of the dwelling.

III. Effect of Proposed Changes:

This bill revises several provisions of law related to estate and tax planning.

Assets Exempt from Creditor Claims

Section 1. Amends s. 222.21(2), F.S., to increase the creditor protection afforded individual retirement accounts and tax-qualified employee benefit plans. The bill states that the owner of a tax-exempt account is afforded protection from creditors. The change is made because technically the owner of an IRA is neither a beneficiary nor participant in the account. The bill also states that governmental and church plans qualify for tax-exempt status under sections 414, 457, and 501(a) of the Internal Revenue Code, are afforded protection from creditors.

¹¹ *Patterson v. Shumate*, 504 U.S. 753 (1992).

¹² Part 2 of Title I of ERISA contains federal spendthrift provisions

¹³ See 29 U.S.C. 1056(d). For a program to be ERISA qualified, it must contain language stating that pension benefits cannot be alienated or assigned. The Supreme Court in *Patterson v. Shumate* decided that this clause was “applicable non bankruptcy law” under s. 541(c)(2) of the Bankruptcy Code and is thus excluded from the debtor’s bankruptcy estate.

¹⁴ See *In re Harris*, 188 B.R. 44 (Bankr. M.D. Fla. 1995); *In re Sutton*, 272 B.R. 802 (Bankr. M.D. Fla. 2002).

The bill provides an exemption from creditor's claims for any fund or account that is maintained in accordance with a master plan, volume submitter plan, prototype plan or other plan, or governing instrument that has been pre-approved by the IRS as tax-exempt under s. 401(a), s. 403(a), s. 403(b), s. 408, s. 408A, s. 409, s. 414, s. 457(b), or s. 501(a) of the Internal Revenue Code of 1986, as amended. The exemption from creditors is eliminated if a subsequent, final determination has been made that the plan or governing instrument is not tax-exempt. Thus, the IRS and Tax Courts will make the determination regarding the tax-exempt status of a plan under this bill.

The bill allows a retirement or profit-sharing plan to qualify for protection from creditors if the person claiming the creditor exemption can prove by a preponderance of the exemption, that the fund or account is in substantial compliance with the requirements for tax-exemption cited in this subsection (2)(a) or would have been in substantial compliance but for the negligent or wrongful conduct of another person.

The bill specifies that it is not necessary for a fund or account covered by subsection (2)(a), F.S., to be maintained in accordance with a plan that is covered by ERISA for the plan's assets to be exempt from the claims of creditors. Thus, tax-exempt status is sufficient to qualify for protection from creditors and the fund or account need not be ERISA qualified to receive the creditor exemption. Also, money or assets that are exempt from creditor's claims under subsection (2)(a) do not lose their exemption from creditors by reason of a direct transfer or eligible rollover that is excluded from gross income under s. 402(c) of the Internal Revenue Code.

The provisions of this section of the bill apply to any proceeding that is filed after the effective date of the act (upon becoming law).

Section 2. Amends s. 222.22, F.S., to provide that funds held in Coverdell Education Savings Accounts, which are tax-advantaged accounts used to save for education expenses, are exempt from creditor claims under Florida law. The bill provides that Coverdell Education Savings Accounts are accorded the same treatment as funds held in the Florida Prepaid College Program and the Florida College Savings Program, which are exempt from creditor claims under existing Florida law. The bill also exempts from creditor's claims health savings accounts authorized under s. 223 of the 1986 Internal Revenue Code.

The bill also provides that the moneys or assets contained in a hurricane savings account are exempt from creditor's claims. The hurricane savings account must be created by the owner of residential real estate in Florida in trust form exclusively for the purpose of paying an insurance deductible or other uninsured portion of the risk of loss on residential property resulting from a hurricane, rising floodwater, or other catastrophic windstorm event. The term "residential property" means property that meets the requirements of a homestead exemption under Section 4, Article X of the Florida Constitution. Thus, the trust account can only be created to cover the insurance deductible on a person's homestead property. The amount of contributions into the hurricane savings trust account cannot exceed twice the windstorm deductible on the homestead property. The trustee must be a bank as defined by s. 658.12, F.S., which will administer the trust

consistent with the requirements of this section. The assets of the trust cannot be commingled with other property except in a common trust fund or common investment fund.

Benefit Plans

Section 3. Amends s. 710.102, F.S., to broaden the definition of the term “benefit plan” to mean a retirement plan that may include, but is not limited to, any pension, profit-sharing, stock bonus, or stock-ownership plan or individual retirement account. Additionally, the bill defines the term “qualified minor’s trust” as a trust that complies with s. 2503(c) of the Internal Revenue Code. That code provision requires that trusts for the benefit of persons under the age of 21 distribute their assets to the beneficiary when the beneficiary reaches the age of 21.

Section 4. Amends s. 710.104, F.S., to provide that a person who has the right to designate the recipient of property transferable upon the occurrence of a future event may nominate a custodian for a minor to receive the property in a benefit plan.

Section 5. Amends s. 710.108, F.S., to allow a benefit plan to be transferred to a custodian for the benefit of a minor pursuant to s. 710.111, F.S. The benefit plan may be delivered to a custodian for the benefit of a minor, to a child’s parents as natural guardians, or to a trustee designated by the owner of the benefit plan upon the death of the owner. The bill also raises from \$10,000 to \$15,000 the amount that may be given to a custodian by certain persons without court involvement.

Section 6. Amends s. 710.116, F.S., to provide that an adult custodian of property for a minor may transfer the custodial property into a qualified minor’s trust.

Section 7. Amends s. 733.808, F.S., to include the broadened definition of “benefit plan” found under the bill in s. 710.102 F.S., within the regulations for the disposition of death benefit proceeds.

Section 8. Amends s. 744.301, F.S., to enable a custodian to collect, receive, manage and dispose of individual retirement accounts (IRA’s) that are created by minors and IRA’s payable to minors as beneficiaries without court order, up to the statutory threshold of \$15,000.

Section 9. The bill takes effect upon becoming a law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

This bill will make additional types of a debtor's assets exempt from creditors' claims. The bill also clarifies that the proceeds of benefit plans may be paid to an adult custodian for the benefit of a minor and that the property of a custodian may be placed in a qualified minor's trust.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.

VIII. Summary of Amendments:

None.

This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.
